

White Collar Crime - USA

Restitution for Criminal Trademark and Copyright Infringement

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Background

Chapter 18 of the US Code makes trafficking in counterfeit labels, packaging, goods and services (Sections 2318 and 2320) and infringement of copyright (Section 2319) criminal offences. Although defendants convicted of these crimes are required to pay restitution to the trademark and copyright holders, courts vary in their approaches to determining the amount of restitution. This update surveys the various approaches employed by the US courts in this evolving area of law.

Restitution is mandatory for a Title 18 "offence against property".⁽¹⁾ Section 2320 explicitly provides that trafficking in counterfeit goods is an offence against property⁽²⁾ and it is likely that Section 2319, the criminal copyright infringement statute, would be interpreted in the same way.⁽³⁾ For an offence resulting in damage to or loss of property, the restitution order shall require the defendant to pay the "value of the property" on the date of the loss or the date of sentencing, whichever is greater.⁽⁴⁾ Since criminal trademark and copyright cases involve damage to intangible rights, measuring the value of the damaged property for the purposes of restitution may prove more challenging.

Notwithstanding the challenges in measuring restitution in criminal trademark and copyright matters, courts typically order restitution in furtherance of the strong policy in favour of compensating crime victims for their actual losses. The government has the burden of demonstrating the amount of the victim's loss only by a preponderance of the evidence.⁽⁵⁾ Thus, in practice, if the government provides evidence allowing the court to make a reasonable estimate of the victim's losses, restitution will be ordered.⁽⁶⁾

If the government does not provide a reliable estimate of the victim's loss, the court need not enter a restitution order. In *United States v Foote*⁽⁷⁾ the court did exactly that. The defendant was convicted of trafficking in counterfeit goods in violation of Section 2320.⁽⁸⁾ The district court held that, because the government had proposed no reliable estimate of the victim's losses, the calculation of restitution would be unduly complicated and a restitution order need not be entered.⁽⁹⁾ In so ruling, the court relied on cases holding that restitution requires real or actual loss to the victim, and that a victim's lost profits must be proved with some certainty.⁽¹⁰⁾

In general, however, and provided that the government provides some reasonable proxy for the victim's loss, the courts have been willing to enter restitution orders on behalf of trademark and copyright crime victims. To date, the courts have applied four different approaches in awarding restitution to rights

holders:

- the victim's net lost profits;
- the victim's lost gross revenue;
- the defendant's gross revenue; and
- a calculation based on civil statutory damages.

Net Lost Profits

Some courts have held that the lost profits to the victim from the sales that it would have otherwise made in the absence of the defendant's infringement are the appropriate measure of restitution. In *United States v Martin*⁽¹¹⁾ the defendant pleaded guilty to trafficking in counterfeit Microsoft Office 2000 CDs in violation of Section 2320. The district court awarded restitution by taking the total retail value of the infringed CDs and applying Microsoft's overall profitability for the year in question to that total value.⁽¹²⁾ Similarly, in *United States v Beydoun*⁽¹³⁾ the defendant pleaded guilty to trafficking in counterfeit cigarettes in violation of Section 2320. The district court ordered restitution based on the retail value (described by the court as "gross profits") of the infringed items.⁽¹⁴⁾ The Fifth Circuit reversed the district court and remanded the case, holding that lost net (not gross) profits from the lost sales were the appropriate measure of the victim's losses.

Lost net profits to the rights holder represents a principled way to estimate the loss caused by the infringement. However, there are two issues to consider, with respect to this approach.

First, to the extent that the goal is to measure the actual loss to the rights holder, a defendant may argue that the government must provide some evidence that the defendant's customers would have paid for the legitimate items if the infringing items had not been available. Where the price differential between the infringing and infringed items is substantial, the defendant may argue that the government cannot provide this evidence.

Second, this approach may prove problematic for certain rights holders. In order to calculate the net lost profits for the lost sales of an infringed product, companies may be required to disclose information on the proprietary cost of the goods sold for the infringed item and, if they are unwilling to do so, risk a 'no restitution' order. In *Martin* this problem was apparently avoided by using the overall profitability figure for Microsoft, which was presumably available from Microsoft's public filings. Victim companies and the government need to be sensitive to this issue and either seek to use publicly available information on the cost of goods sold, as in *Martin*, or, if that is impossible, seek safeguards (eg, sealed filings, sealed courtrooms and protective orders) to protect their proprietary information.

Lost Gross Revenue

One district court has awarded restitution based on the lost gross revenue to the rights holder that would have been generated in the absence of the sales of the infringing items. In *United States v Milstein*⁽¹⁵⁾ the defendant was convicted for distributing counterfeit pharmaceuticals in violation of Section 2320. The district court ordered the defendant to pay \$3.5 million in restitution to the drug manufacturers whose trademarks were misappropriated on the basis that this is what the defendant would have paid had he purchased the products from the manufacturers for distribution in the United States.⁽¹⁶⁾ In affirming the district court's restitution order as a reasonable estimate of the victims' lost sales, the Second Circuit relied on the fact that lost sales were an appropriate damages measure in a civil Lanham Act trademark infringement case, and therefore an appropriate "value of the property" taken under the criminal restitution statute.⁽¹⁷⁾

Lost gross revenue to the victim is the most favourable restitution approach for the victim employed to date. However, as in the net profits approach discussed above, a defendant would be likely to argue that the government would have to demonstrate that the defendant's customers would have purchased the legitimate items if the infringing items had not been available. A defendant might also argue that this approach overstates the actual loss to the victim because it does not account for the cost to the victim of

manufacturing the legitimate items. However, as in *Milstein*, the government may persuade the court that gross revenue meets the reasonable estimate threshold in measuring a victim's losses for the purposes of restitution.

Defendant's Gross Revenue

Some courts have held that the defendant's gross revenue from the sales of the infringing items is a reasonable proxy for the victim's losses. In *United States v Chay*,⁽¹⁸⁾ the defendant pleaded guilty to trafficking in counterfeit documents and packaging for pirated computer programs in violation of Section 2318 and agreed to pay restitution for "all losses" caused by his crimes. The district court ordered the defendant to pay restitution to the 52 victim copyright holders based on the defendant's gross sales of the pirated computer games.⁽¹⁹⁾ The defendant argued that the restitution order should have been reduced by his costs, and that therefore his net profit was the appropriate measure of restitution.⁽²⁰⁾ The Seventh Circuit rejected this argument, reasoning that a copyright holder ought not to be required to "subsidize the cost of [the defendant's] illegal activity", and that therefore the district court had not abused its discretion by awarding restitution on the basis of the defendant's gross sales.⁽²¹⁾

In *United States v Hicks*,⁽²²⁾ the defendant modified satellite descrambling boards to allow customers to view satellite channels for which they had not paid, and pleaded guilty to copyright infringement under Section 2319. The district court first sought to calculate restitution on the basis of how much lost revenue to the service providers the additional 15 channels represented.⁽²³⁾ However, because this could not be established with certainty, the court had recourse to the amount that the defendant had earned for modifying the boards, which was \$20,000.⁽²⁴⁾ On appeal, the defendant argued that the \$20,000 restitution award was excessive because it represented his gain instead of the victim's loss.⁽²⁵⁾ The Fourth Circuit rejected this argument and noted that although the restitution was based on the defendant's revenue, "the court's real aim was to have him make restitution of the amount lost by the victim".⁽²⁶⁾

These holdings show that, although restitution is designed to compensate a victim for its actual losses, the courts will look to other measures of restitution if necessary to provide at least some compensation to the victim. Thus, while the defendant's gain from the infringing activity may differ significantly from the actual loss to the victim, some courts view it as a reasonable (and indeed conservative) proxy for the victim's losses, and will order restitution on that basis.

Civil Statutory Damages

In *United States v Manzer*,⁽²⁷⁾ the defendant was convicted of copyright infringement for the modification of descrambling devices to permit the unauthorized decryption of cable satellite transmissions. The district court ordered restitution in the amount of \$2.7 million based on its finding that the defendant had sold 270 modified descrambling devices, and then estimating that each package was worth \$10,000 by reference to the minimum statutory damage award authorized in a civil copyright infringement case.⁽²⁸⁾ In affirming the award of restitution the Eighth Circuit, noting the wide discretion afforded to district courts in ordering restitution, reasoned that it was appropriate for the district court to look to the civil statutory remedy for guidance and that, in any event, the actual loss was far greater than the amount of restitution awarded.⁽²⁹⁾

Manzer confirms the wide latitude given to district courts in fashioning orders of restitution. Moreover, where the restitution order understates the amount of actual loss, as it did in *Manzer*, and as it is likely to do in cases using the defendant's gross revenue as the measure of restitution, appellate courts are unlikely to disturb the restitution order.

Comment

Given the wide discretion afforded to district courts in fashioning orders of restitution and the policy in favour of compensating crime victims through criminal orders of restitution, it is likely that district courts will order restitution in cases involving criminal trademark and copyright infringement. Even though these crimes involve damage to intangible property rights and may present some difficulties in valuing the actual loss to the victim, provided that some evidence of actual loss is provided by the government, or some other reasonable proxy of the victim's loss is asserted at sentencing, a district court will be on firm

ground in ordering restitution in criminal trademark and copyright cases. In order to best represent their clients, counsel outside the United States representing defendants subject to prosecution in the United States for IP crimes must understand the varying approaches that the US courts take in ordering restitution in such cases.

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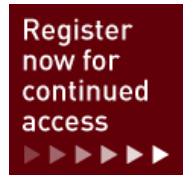
Endnotes

- (1) 18 USC § 3663A(c)(1)(A)(ii).
 - (2) 18 USC § 2320(b)(4).
 - (3) See *United States v Milstein* 481 F 3d 132, 137 (2nd Cir 2007): “[I]ntellectual or intangible property falls within the purview of criminal statutes designed to protect property.”
 - (4) 18 USC § 3663A(b)(1).
 - (5) 18 USC § 3664(e).
 - (6) *United States v Milstein* at 137.
 - (7) 2003 US Dist LEXIS 19312 (D Kan 2003).
 - (8) *Id* at *2.
 - (9) *Id* at *20 (citing Section 5E1.1(b)(2)(B) of the US Sentencing Guidelines).
 - (10) *Id* (citations omitted).
 - (11) 64 Fed Appx 129 (10th Cir 2003), cert denied 540 US 906.
 - (12) *Id* at 131.
 - (13) 469 F 3d 102 (5th Cir 2006).
 - (14) *Id* at 107-108.
 - (15) 481 F 3d 132 (2nd Cir 2007).
 - (16) *Id* at 135.
 - (17) *Id* at 137, n 3. Notably, the court did not consider whether the victim’s net sales were the more appropriate measure of restitution because the defendant had not raised that issue on appeal. *Id*.
 - (18) 281 F 3d 682 (7th Cir 2002).
 - (19) *Id* at 684.
 - (20) *Id* at 685.
 - (21) *Id* at 686-687.
 - (22) 1995 US App Lexis 1215 (4th Cir 1995).
 - (23) *Id* at *4.
 - (24) *Id* at *4-5.
 - (25) *Id* at *7.
 - (26) *Id* at *7-8.
 - (27) 69 F 3d 222 (8th Cir 1995).
 - (28) *Id* at 228.
 - (29) *Id* at 228-30.
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